



BOARD OF GOVERNORS  
OF THE  
**FEDERAL RESERVE SYSTEM**  
WASHINGTON, D. C. 20551

BEN S. BERNANKE  
CHAIRMAN

March 21, 2006

The Honorable Brad Sherman  
House of Representatives  
Washington, D.C. 20515

Dear Congressman:

I am pleased to enclose my responses to the questions you asked during the February 15 hearing before the Committee on Financial Services regarding the semiannual monetary policy report to Congress. A copy will be forwarded to the Committee for inclusion in the hearing record.

Please let me know if I can be of further assistance.

Sincerely,

A handwritten signature in dark ink, appearing to be "Be Bernanke", is written below the word "Sincerely,".

Enclosures

Insert page 67, after line 1631:

Chairman Bernanke subsequently provided the following for the record:

For a variety of reasons, Congress has sought to maintain the separation of banking and commerce in the United States. Congress reaffirmed its desire to keep banking and commerce separate in 1999 when it passed the Gramm-Leach-Bliley Act (GLB Act). That act closed the unitary thrift loophole, which previously allowed commercial firms to acquire a savings association, and authorized financial holding companies as a general matter to affiliate only with companies that are engaged in activities that have been determined to be financial in nature or incidental to financial activities. The GLB Act also placed limits on "financial subsidiaries" of member banks. These limits, among other things, allow financial subsidiaries of member banks to engage only in activities that its parent bank may conduct directly or that have been determined to be financial in nature or incidental to financial activities by the Treasury Department in consultation with the Board.

The question of whether, or to what extent, the mixing of banking and commerce should be permitted is an important issue and one that, we believe, should be made by Congress. The decision has important ramifications for the structure of the American financial system and the economy, particularly because any widespread combinations of banking and commerce likely would be irreversible. It is for these reasons that the Board has encouraged Congress to review the exemption in current law that allows a commercial firm to acquire an FDIC-insured industrial bank (ILC) chartered in certain states without regard to the limits Congress has established to maintain the separation of banking and commerce. Continued exploitation of the ILC exception threatens to remove this important policy decision from the hands of Congress.

Policies designed to maintain the separation of banking and commerce inevitably lead to questions as to what activities are financial and what activities are commercial. Under current law, Congress has determined that a number of activities, including securities underwriting and dealing, insurance underwriting and agency activities, various mutual fund activities and merchant banking, are all financial activities. Congress also has authorized the Board (in consultation with the Treasury Department) to determine whether other activities are financial in nature or incidental to financial activities and, thus, permissible for financial holding companies. Congress has vested the Office of the Comptroller of the Currency with the authority to determine what activities are part of, or incidental to, the business of banking and permissible for national banks under the National Bank Act.